Dragoman Digest.

30.04.2021

Turkey's Black Sea megaproject

Significant doubts remain about the viability of the project

Throughout his tenure, **Turkish** President **Recep Tayyip Erdoğan** has always displayed a penchant for megaprojects. Erdoğan's latest megaproject – or vanity project as critics assert – is a plan to build Canal Istanbul, a much-vaunted 45km artificial alternative to the Bosporus Strait which links the Black Sea with the Sea of Marmara. Authorities have officially given the green light to development plans and Erdoğan is aiming to begin construction this summer. A decisive factor justifying Erdoğan's haste seems to be a long sought-after offer of **Chinese** finance.

The project is hugely controversial and is vehemently opposed by local politicians on environmental (especially impacts on local marine life and water supplies), safety and commercial grounds. The area where the canal is to be built is prone to earthquakes. The commercial viability of the at least US$9 billion project appears to be particularly sketchy. Under the 1936 Montreux Convention regulating transit of the Bosporus and guaranteeing freedom of commerce, Turkey is only allowed to charge a nominal fee, normally around US$4,500 per ship. According to Bloomberg, only an even lower fee would incentivise usage of Canal Istanbul and the difference would have to be made up by increased volumes of traffic. The trend however is in the opposite direction, with traffic in the Bosporus falling more than 25 percent over the last decade.

Canal Istanbul is also mired in geopolitical complexity. In recent months, Erdoğan has sought – with limited success thus far – to rebuild frayed ties with the **EU** and **US**. Because it would not be regulated by the 1936 Montreux Convention which restricts the passage of non-littoral naval vessels, Canal Istanbul would likely significantly increase NATO's presence in the **Russian**-dominated Black Sea. This has attracted rare, open criticism from Eurasianist elements of Turkey's military and foreign policy establishment, who are deeply sceptical of the West. If realised, it would also draw the ire of Russian President **Putin**, with whom Erdoğan has a complicated relationship involving both dependency and competition. Of course, the appeal of Canal Istanbul as an olive branch to the West is complicated by likely Chinese involvement in the project. China's rumoured financing and construction role has also been a further source of domestic criticism. With Turkey already involved in a series of regional conflagrations, unusually deft diplomacy may be required to prevent its foreign policy from collapsing under the weight of its own contradictions.

Biden administration open to carbon border adjustment mechanism

A multilateral carbon pricing scheme would likely increase momentum behind the energy transition

"Climate tsar" John Kerry has signalled that the **Biden** administration is considering implementing a Carbon Border Adjustment Mechanism (CBAM) to incentivise the international community to align with the **US**' climate abatement targets. A hypothetical CBAM would place a carbon price on imports to prevent "carbon leakage," which occurs when companies relocate production to countries with less ambitious emissions rules. The US has previously resisted such an initiative, describing it as a "last resort" with "serious implications" for bilateral relations. Resistance from the White House was likely due to scepticism about the political feasibility of introducing a carbon price. However, recent endorsement from influential business groups such as the American Petroleum Institute may indicate that public opinion is shifting.

Although the technical details of a mechanism have not yet been defined, the US may collaborate with the **EU**, which is planning to enact a CBAM pilot scheme by 2023. One barrier to such a scheme is the potential disparities in the rigour of carbon accounting and reporting. Inconsistencies between jurisdictions could result in an advantage for countries with lax standards. **Canada** and the US have already agreed to "moving forward" with plans to penalise high-emitting countries. Synchronisation of global efforts would clearly have greater impact than a unilateral scheme. The International Monetary Fund has proposed that a small "carbon club" comprising the largest global emitters institute an international carbon price floor. The club would place stricter requirements on advanced economies like the US and the EU and differentiate pricing for countries with lower levels of economic development such as **India**. In 2020, existing carbon pricing schemes covered approximately 20 percent of annual emissions. If an agreement was made between the G20 for example, carbon pricing would cover up to 80 percent of global emissions. A multilateral agreement might be a game changer for meeting the world's ambitious interim 2030 targets and future net-zero targets.

EU reveals outlines of Indo-Pacific Strategy

If its strategy is properly funded, the EU has the clear potential to provide alternative options to the region

On April 19, the Council of the **European Union** formally asked the European Commission to draw up an Indo-Pacific strategy by September this year. An EU Council report accompanying the announcement reveals what will likely be the strategy's broad contours. Although **China** is not explicitly named in the report as a threat to be countered, pledges to help ensure that the "regional architecture remains open and rules-based" are a clear if not implicit reference to the challenges posed by Beijing's more assertive behaviour. At the same time, the report's reference to the now jeopardised China-EU Comprehensive Agreement on Investment shows that Brussels also clearly recognises the need to engage with Beijing.

In hard power terms, the most substantial part of the report is the suggestion that the EU will maintain a "meaningful European naval presence in the Indo-Pacific." What this will look like remains uncertain. The **UK**'s exit significantly reduced the EU's naval power, and it is unclear who apart from **France**, and to a lesser extent **Germany**, will be willing and able to deploy significant naval assets. Of course, military power is just one part of the equation. A robust diplomatic and economic presence, as well as a military one, will also be crucial for the maintenance of regional balance. It is in these "softer" areas that the EU can make more of a difference by providing Indo-Pacific countries with alternative economic and diplomatic options. Among other things, the report envisages an expanded EU role in digitisation (Southeast Asia is a likely focus), trade (FTAs with **Australia**, **Indonesia** and **New Zealand** are specifically mentioned), connectivity, health, sustainable finance and participation in regional diplomatic fora. Ultimately, the devil will be in the detail of how September's strategy translates these high-level pledges into specific outcomes.

China's master plan for bringing big tech to heel

Beijing appears to view economic trade-offs as a necessary evil

Things haven't quite been the same for China's tech industry since paramount leader **Xi Jinping** personally pulled the plug on Ant Pay's IPO in November last year. This dynamic was on full display at last month's annual Two Sessions parliamentary gathering, where Tencent founder Pony Ma called for stricter regulation of his own company. Overall, at least US$700 billion in shareholder value has been lost across China's tech industry. Beijing is only getting started. According to a report in *The Economist*, China's leaders have an unofficial master plan for the sector, the first part of which involves the "de-tycoonification" of large firms. A common refrain is that if he ran, Jack Ma would win democratic elections in China if they were ever to be held. This level of popularity is obviously unacceptable for the Communist Party. On a related note, the ability of Alibaba to influence public opinion through its media assets has caused particular anxiety in Beijing. Reports suggest that Beijing has asked Alibaba to divest its media assets, whilst Tencent confirmed that it is working with regulators to assess past investments across multiple industries. Most alarmingly for tech companies is what appears to be Beijing's ultimate objective to commandeer their data reserves – some of the most advanced in the world. Having control over such vast reserves would be a fillip to Beijing's own plans in this area, including the PBOC's thus far frustrated plans to create a centralised credit scoring system.

It is not only big tech that are feeling the effects of this broader crackdown. So far this year, almost ninety tech unicorns have shelved IPO plans because of the shifting political winds. With China expected to report its first population decrease since Mao's disastrous Great Leap Forward, the importance of technology and innovation will only grow as Beijing attempts to move away from a labour-heavy growth model. Just how far Beijing will go in sacrificing economic dynamism and international tech competitiveness to assert political control remains to be seen.

Shifting dynamics in the Middle East drive a Saudi-Iranian recalibration

Secret regional meetings held to discuss Syria, Lebanon and Yemen

Since January, several secret meetings have reportedly been held between regional powers and **Iran**. Iran met first with the **UAE**, then **Jordan**, **Egypt** and **Saudi Arabia**. Iran's meeting with Saudi – held earlier this month – appears to be of greatest impact. The discussions were facilitated by **Iraq**'s Prime Minister **Mustafa al-Kadhimi**. Although no public announcements have been made to confirm or deny the meeting, Saudi Crown Prince **Mohammed bin Salman**'s (MbS) has noticeably tempered his tone toward Iran. Tellingly, MbS said that Saudi is seeking "good relations with Iran" and is "working with our partners in the region to overcome our differences." A spokesperson from Iran's Foreign Ministry said that it "welcomes the change of tone" from Saudi. The two countries severed diplomatic ties in 2016.

Whilst few details have been released, the war in Yemen was the primary focus of the meetings. The impact of unstable security and political dynamics in **Syria** and **Lebanon** and Iran's support for proxies in the region was also discussed. These conflicts have the potential to directly undermine countries' security, attractiveness as investment destinations and internal stability. MbS may also be seeking to repair his standing with the Biden administration. However, Biden's intent to reduce the **US**' role in the region is arguably the most compelling reason for the meetings. Biden has pledged to withdraw US troops from **Afghanistan** by 11 September this year and has ended US support for Saudi in Yemen. Biden's actions have been interpreted in the region as implying that the US' security shield – largely in place to protect the Gulf states from Iran and violent extremist groups – is no longer unconditional. There is no guarantee that the meetings will be successful in resolving "forever" wars in the region. However, it is undoubtedly material that this is an inclusive dialogue initiated and led by the region itself.